79-464

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

PAUL DAVID OSTROW,

Petitioner,

—v—

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Other Authorities

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Petitioner prays that a writ of *certiorari* issue to review the judgment of the United States Court of Appeals for the Second Circuit entered on July 6, 1979, petition for rehearing denied on August 21, 1979.

Opinions Below

The opinion of the United States District Court for the Eastern District of New York denying petitioner's motion for a new trial pursuant to Rule 33 F.R.Cr.P., is printed in Appendix B hereto. The opinion of the United States Court of Appeals for the Second Circuit, which affirmed the judgment of the District Court is printed in Appendix A hereto.

Jurisdiction

The judgment of the United States Court of Appeals was entered on July 6, 1979, petition for rehearing denied on August 21, 1979. Jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

Questions Presented

1. Did the Court below err in refusing to vindicate petitioner's constitutional right to introduce reliable, relevant, admissible evidence consisting of the sworn testimony of an unavailable witness that was essential to his defense in a criminal prosecution?

2. Did the Court below err in construing F.R.Evid. 804, in a manner contrary to decisions of other Courts of Appeals, to its own previous decision, and to the plain meaning of the rule, so as to exclude the sworn testimony of an unavailable witness crucial to the defense.

Constitutional Provisions Involved

AMENDMENT V

"No person shall * * * be deprived of life, liberty, or property, without due process of law; * * *"

AMENDMENT VI

"In all criminal prosecutions, the accused shall enjoy the right * * * to have compulsory process for obtaining witnesses in his favor, * * *"

Rule Involved

The rule involved is F.R.Evid. 804. The text of the rule is printed in Appendix C hereto. The relevant portion of the rule provides as follows:—

> (b) Hearsay exceptions. The following are not excluded by the hearsay rule if the declarant is unavailable as a witness:
>
> (1) Former testimony. Testimony given as a witness at another hearing of the same or different proceeding, or in a deposition taken in compliance with law in the course of the same or another proceeding, if the *party* against whom the testimony is now offered, or, in a civil action or proceeding, a *predecessor in interest,* had an *opportunity* and *similar motive* to develop the testimony by direct, cross, or redirect examination.

Statement of the Case

Petitioner was convicted in the United States District Court for the Eastern District of New York on two counts of wilfully attempting to evade United States personal income tax in violation of 26 U.S.C. Section 7201. Following a trial before a jury, judgment of acquittal was entered as to one other count of tax evasion and as to three counts under 26 U.S.C. Section 7206(1) and (2) relating to the preparation and filing of corporate income tax returns. A sentence of three years probation following a term of one year imprisonment, all but two months of which was suspended, was imposed.

The bookkeeping treatment of certain payments by two corporations, the Ostrow Textile Co., Ltd. ("OTC") and Plej's Rock Hill, Inc. ("Plej's") was the principal issue in this tax evasion case. It was undisputed at trial that Segundo Martinez, former Comptroller of the corporations, made or supervised the making of the book entries in question. Petitioner did not make the questioned entries.

On April 25, 1975, Martinez testified before the Internal Revenue Service ("the Service") under oath and in response to compulsory process issued by the Service pursuant to 26 U.S.C. Section 7602. At this point, an investigation of the corporations had been in progress for approximately eighteen months. Martinez testified that the book-

keeping errors were due to his negligence and were contrary to the instructions of Petitioner. The representatives of the Service confronted Martinez with specific book entries and questioned him about them. Martinez did *not* assert the privilege against self-incrimination but answered all questions within the scope of the summons which had compelled his appearance. The testimony was recorded stenographically.

Approximately six months later, in October 1975, the Service informed Martinez for the very first time that he himself was a target of their criminal tax investigation. Only at this time, confronted with the Service's warning, did Martinez decline to respond to additional questioning. Martinez, in the presence of his own counsel, did respond to further questioning by an Assistant United States Attorney and a Special Agent of the Internal Revenue Service in October 1978, only one month before the return of the indictment in this case.

Martinez was indicted for aiding and assisting the preparation of false corporate tax returns on November 15, 1978. Although a United States citizen, Martinez has resided regularly in his native Colombia for approximately three years, and did not appear at trial, either as a defendant or a witness.

Petitioner issued a subpoena to Martinez in Bogota, Colombia in accordance with 28 U.S.C. Section 1783 and provided him with an airline ticket from Bogota to New York. Martinez's counsel appeared in the District Court and represented that Martinez was unable to leave his place of employment in Colombia and would assert his privilege against self-incrimination if an attempt were made to take his testimony by deposition pursuant to F.R.Cr.P. 15.

In reliance upon his constitutional right to present a defense, petitioner requested that the Government compel Martinez's testimony pursuant to 18 U.S.C. Section 6003 (b)(1). In the alternative, Petitioner offered in evidence the transcript of Martinez's prior sworn testimony taken by the Service on April 25, 1975. The Government refused to compel Martinez's testimony and upon the objection of the Government, the District Court did not admit into evidence the transcript of the former testimony.

The subject matter of the proffered former testimony pertains to the central issue in the two counts on which the jury returned a verdict of guilty. The District Court found Martinez unavailable and acknowledged the clear importance of the evidence to petitioner's defense and twice emphasized that its exclusion could not be considered harmless. Portions of the transcript of the District Court's findings are printed in Appendix D hereto.

It is submitted that the exclusion of Martinez' sworn testimony denied petitioner his constitutional rights and is plainly erroneous under F.R.Evid. 804.

Reasons for Granting the Writ

I.

The United States Court of Appeals for the Second Circuit rendered a decision as to an important question of constitutional law in conflict with applicable decisions of this Court and of other Courts of Appeals, which excluded the exculpatory sworn testimony of an unavailable witness.

This Court has long recognized that a defendant's right to introduce reliable exculpatory evidence in a criminal prosecution is an essential component of Due Process Law. This fundamental right, also guaranteed by the Compul-

sory Process Clause of the Sixth Amendment, was recognized by this Court in *Washington* v. *Texas,* 388 U.S. 14, 19 (1967) in words that merit repetition here:

> The right to offer the testimony of witnesses, and to compel their attendance, if necessary, is in plain terms the right to present a defense, the right to present the defendant's version of the facts as well as the prosecution's to the jury so it may decide where the truth lies. Just as an accused has the right to confront the prosecution's witnesses for the purpose of challenging their testimony, he has the right to present his own witnesses to establish a defense. This right is a fundamental element of due process of law.

In *Chambers* v. *Mississippi,* 410 U.S. 284, 302 (1973), this Court held that a criminal defendant was denied Due Process of Law because of the trial Court's ruling excluding exculpatory out-of-court statements from evidence on the basis of a limited interpretation of the declaration against interest exception to the hearsay rule. This Court's delineation of the basis for its decision states the controlling standard of law which the court below erroneously failed to apply:

> The testimony rejected by the trial court here bore persuasive assurance of trustworthiness and thus was well within the basic rationale of the exception for declarations against interest. That testimony also was critical to Chambers' defense. In these circumstances, where constitutional rights directly affecting the ascertainment of guilt are implica' d, the hearsay rule may not be applied mechanistically to defeat the ends of justice.

An unbroken line of decisions of this Court have recognized and applied the principle stated in *Chambers* v. *Mississippi, supra,* at 302, that, "[F]ew rights are more fundamental than that of an accused to present witnesses in his own defense." *See Davis* v. *Alaska,* 415 U.S. 308 (1974); *Brooks* v. *Tennessee,* 406 U.S. 605 (1972); *Webb* v. *Texas,* 409 U.S. 95 (1972); *In re Oliver,* 333 U.S. 257 (1948).

By failing to vindicate petitioner's constitutional right to introduce reliable exculpatory evidence and excluding Martinez's testimony, the Court of Appeals for the Second Circuit reached a result in direct conflict with the decisions of this Court and of other Courts of Appeals. In *Pettijohn* v. *Hall,* 599 F.2d 476 (1st Cir. 1979), the Court of Appeals for the First Circuit relied upon *Chambers* in upholding a criminal defendant's Due Process right to offer an exculpatory, out-of-court indentification as part of his or her defense. Significantly, the First Circuit held that under the Due Process rationale of *Chambers,* "a judge cannot keep important yet possibly unreliable evidence from the jury," where it is critical to the defense. 599 F.2d at 481.

The decision of the Second Circuit conflicts with that of the Court of Appeals for the Sixth Circuit in *United States* v. *Toney,* 599 F.2d 787 (6th Cir. 1979), a case which is virtually indistinguishable from that of petitioner. In *Toney,* a bank robbery prosecution, the defense contended that certain "bait money" possessed by the defendant had been won at gambling. The defense called one King who declined to testify on self-incrimination grounds. The District Court rejected the defendant's offer of a statement given by King to the Federal Bureau of Investigation which corroborated the defense position. The Sixth Circuit reversed because, "[T]he potential value of the King statement to Toney's defense cannot be overestimated," and "'the interests of justice' demanded that the jury consider it". 599 F.2d at 790. Identical considerations here dictate that Martinez's testimony which, unlike King's statement, was under oath and

subject to examination by the Government, at a formal administrative hearing, should have been admitted.

The interpretation of the mandate of this Court in *Chambers* by other Courts of Appeals and State Supreme Courts is in conflict with the decision below. *See United States* v. *Morrison,* 535 F.2d 223 (3rd Cir.), *cert. denied, sub nom, Boscia* v. *United States,* 429 U.S. 824 (1976) (requiring the Government to immunize a key defense witness); *Wisconsin* v. *Gagnon,* 497 F.2d 1126, 1129 (7th Cir. 1974) (holding striking of direct testimony of defense witness unconstitutional); *Commonwealth* v. *Hackett,* 225 Pa. Super. 22, 307 A.2d 334, 338 (1973) ("absence of a fair oportunity to defend against the Commonwealth's accusations in a criminal trial constitutes a denial of the due process of law. . . . The protection of innocent defendants must override any technical adherence to a policy that excludes evidence on the grounds of hearsay."); *State* v. *Dehler,* 257 Minn. 549, 102 N.W.2d 696 (1960) ("When personal appearance of witnesses on behalf of the accused is unavailable, his rights are not violated where the testimony can be received by deposition."). The decision below is also at odds with the conclusion of a leading commentator on a defendant's right to introduce reliable exculpatory evidence:

> On the other hand, if exculpatory testimony would otherwise be unavailable . . . the defendant has a constitutional right to introduce the evidence in its next most reliable form—whether the substitute comes in the form of a deposition, or an out-of-court statement.
>
> P. Westen, *The Compulsory Process Clause,* 74 Mich. L.Rev. 191, 304 (1975).

Assessed under the foregoing standards, the decision below is constitutionally offensive. The proferred testimony

bears every imaginable indicia of reliability. It was under oath and taken at the instance of and subject to thorough examination by the Government; it was stenographically recorded and given in the course of regularly-conducted administrative proceedings; it constituted an admission of negligence and was therefore contrary to the interest of the declarant. The Government can hardly complain that its examination of the witness was incomplete since it was the Government that used its compulsory process to take the testimony. Moreover, Martinez was questioned by the Government only a month before indictment and statements made by the witness on that occasion could have been offered in rebuttal under F.R.Evid. 806.

The proferred testimony was essential to a fair adjudication of petitioner's case. Martinez was literally the only witness having direct knowledge of the preparation of the bookkeeping entries that were the central issue in the Government's case.* The exclusion of the only sworn testimony bearing directly on this subject of necessity led to a judgment "founded on a partial or speculative presentation of the facts," *United States* v. *Nixon,* 418 U.S. 683, 709 (1974), a result which if allowed to stand, would not only strip petitioner of his own constitutional rights, but would be inimical to the ends of justice.

This case presents an important question of constitutional law which should be determined by this Court. The decision below is plainly erroneous and inconsistent with the opinions of this Court and of other Courts of Appeals, and accordingly it is highly appropriate that the petition for a writ of certiorari be granted.

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* The constitutional infirmity in the decision herein is further demonstrated by the fact that the exclusion of Martinez' testimony compelled petitioner to testify at his own trial. *Brooks* v. *Tennessee,* 406 U.S. 605, 611 (1972); *Griffin* v. *California,* 380 U.S. 609, 614 (1965).

II.

The United States Court of Appeals for the Second Circuit interpreted the Federal Rules of Evidence in a manner in conflict with applicable decisions of other Courts of Appeals and which departs from established practice in admitting former sworn testimony.

Since Martinez was indisputably an unavailable witness,* his prior sworn testimony should have been admitted under F.R.Evid. 804(b). Rule 804(b)(1) contains three requirements for the admission of former testimony: (1) the declarant is unavailable, (2) the testimony was given at a hearing or deposition, and (3) the party against whom it is offered had an opportunity and similar motive to develop the testimony. The Court of Appeals for the Second Circuit erred in concluding that these requirements were not met here.

It appears that the only rationale offered for the Court of Appeals' decision is the suggestion that the examination was not "sufficiently focused" at the time the testimony was taken. This requirement appears no where in either the text of Rule 804 or in any prior decision of this Court or of any Court of Appeals.

Prior to the decision below, it had been universally recognized that the admissibility of former testimony depends on the existence of an *opportunity* to examine the witness and not on the actual focus of the examination. *United States* v. *Allen,* 409 F.2d 611, 613 (10th Cir. 1969) (". . . the test is the opportunity for full and complete cross-examination

* The District Court found Martinez to be an unavailable witness under F.R.Evid. 804(a). The Government did not challenge this conclusion, nor did the Court of Appeals upset this finding. In light of Martinez's absence from the country and assertion of the privilege against self-incrimination, the finding of unavailability is unassailable.

rather than the use which is made of that opportunity."); 4 Weinstein & Berger, *Weinstein's Evidence* ¶ 804(b)(1) [02] at 804-5 (1977); 5 Wigmore, *Evidence,* § 1371 at 51 (2d ed. 1940); McCormick, *Evidence,* § 261 at 626 (2d ed. 1972).

The decision below is in conflict with the ruling of this Court in *California* v. *Green,* 399 U.S. 149 (1970). In *Green,* this Court upheld the admissibility of testimony given at a preliminary hearing, in spite of the fact that the focus of such a proceeding, i.e., the existence of probable cause, is far more narrow than that of an actual criminal trial. 399 U.S. at 165. Prior to the decision herein, literally every Court of Appeals, including the Second Circuit, had upheld the admission of former testimony so long as an opportunity for cross-examination existed, regardless of the actual examination conducted. *See, e.g., Phillips* v. *Wyrick,* 558 F.2d 489, 496 (8th Cir. 1977), *cert. denied,* 434 U.S. 1088 (1978); *United States* v. *Birnbaum,* 373 F.2d 250, 264 (2nd Cir. 1967), *cert. denied,* 389 U.S. 837 (1968); *Tug Raven* v. *Trexler,* 419 F.2d 536, 543 (4th Cir. 1969), *cert. denied,* 398 U.S. 938 (1970); *United States* v. *King,* 552 F.2d 833, 843 (9th Cir. 1976), *cert. denied,* 430 U.S. 966 (1977); *Coppedge* v. *United States,* 311 F.2d 128 (D.C. Cir. 1962), *cert. denied,* 373 U.S. 946 (1963).

The Martinez testimony was by no means an informal interview conducted by investigating agents. The testimony was under oath, and was given at the offices of the Internal Revenue Service, in question and answer form and stenographically recorded. The proceedings before the Internal Revenue Service were subject to the provisions of the Administrative Procedure Act. This Court has denominated the Internal Revenue Service personnel who take such testimony as "hearing officers". *Reisman* v. *Caplin,* 375 U.S. 440, 445 (1964). Any witness wilfully falsifying his testimony at

such a proceeding would be liable for prosecution for perjury 18 U.S.C. § 1621, making false statements to a Federal official, 18 U.S.C. § 1001, and making false statements to an Internal Revenue officer, 26 U.S.C. § 7207. Moreover, the Internal Revenue Manual provides Internal Revenue Service personnel with specific directions to conduct thorough examinations, to prepare carefully before taking testimony, and to "follow through" on all questions and answers. CCH, *Internal Revenue Manual,* Vol. IV, 9900, § 246.1(2).

The decision of the Court of Appeals for the Second Circuit excluding Martinez' testimony conflicts with the decision of the Court of Appeals for the Tenth Circuit in *United States* v. *Brown,* 411 F.2d 1134 (10th Cir. 1969). *Brown* involved a situation virtually identical to that at bar. In *Brown* the Tenth Circuit interpreted F.R.Evid. 804(b)(1) as requiring that testimony given before the Internal Revenue Service under circumstances essentially identical to those in the present case should be admitted on motion of the defendant. *See also United States* v. *Carlson,* 547 F.2d 1346 (8th Cir. 1976), *cert. denied,* 431 U.S. 914 (1977).

Petitioner's case presents an important legal issue involving the interpretation of the Federal Rules of Evidence. The question presented by this case has not been passed upon by this Court. This Court has in the exercise of its rule-making power promulgated the Federal Rules of Evidence. It is respectfully submitted that the present case, which presents an important question of interpreting these rules and which has been the subject of conflicting decisions by the Courts of Appeals, should be reviewed by this Court.

CONCLUSION

For the reasons above stated, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

79-1115

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York on the sixth day of July, one thousand nine hundred and seventy-nine.

PRESENT:

HON. ELLSWORTH A. VAN GRAAFEILAND, Circuit Judge
HON. DUDLEY B. BONSAL, District Judge*
HON. JON O. NEWMAN, District Judge**

UNITED STATES OF AMERICA,

Appellee,

—v—

PAUL DAVID OSTROW,

Appellant.

Defendant Paul Ostrow appeals from his conviction in the United States District Court for the Eastern District of New York, Dooling, J., on two counts of wilfully evading personal income tax. 26 U.S.C. § 7201.

Appellant's principal contention was that the District Judge erred in excluding as hearsay certain statements made by one Martinez in the course of an interview with agents of the Internal Revenue Service. We perceive no error. The prior testimony exception, Fed. R. Evid. 804 (b)(1), requires a prior hearing or deposition at which the opposing party had an opportunity and a similar motive to examine the declarant on the pertinent issue. Martinez's testimony here was stenographically recorded, but the inter-

rogation by the IRS agents was not sufficiently focused upon the issue on which the testimony was offered. By the time the IRS agents were prepared to examine Martinez on that issue, he frustrated their questioning by pleading the Fifth Amendment. *Compare Brown* v. *United States,* 411 F.2d 1134, 1137 (10th Cir. 1969). Martinez's testimony was not a declaration against interest, Fed.R.Evid. 804 (b)(3), because he was only dimly aware of any risk of liability and his remarks seemed calculated to avoid responsibility for the actions of him and Ostrow. There were too few guarantees of trustworthiness to invoke the catchall exception of Fed.R.Evid. 804(b)(5). The Government was entitled to prosecute Martinez and was therefore required to inform him of his Fifth Amendment rights. Under the circumstances, there was no obligation to extend Martinez immunity. *See United States* v. *Lang,* 589 F.2d 92, 96 (2d Cir. 1979).

We have considered appellant's other contentions and find them meritless. Accordingly, the conviction is affirmed.

/s/ Ellsworth A. Van Graafeiland,
Ellsworth A. Van Graafeiland,
U.S.C.J.

/s/ Dudley B. Bonsal,
Dudley B. Bonsal,
*U.S.D.J.**

/s/ Jon O. Newman,
Jon O. Newman,
*U.S.D.J.***

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* United States District Judge, Southern District of New York, sitting by designation.

** United States District Judge, District of Connecticut, sitting by designation.

APPENDIX B

Memorandum and Order

UNITED STATES DISTRICT COURT

Eastern District of New York

78 CR 678

United States of America,

—against—

Paul D. Ostrow,

Defendant.

Appearances:

Jules Ritholz and Stuart E. Abrams (Kostelanetz & Ritholz of Counsel) for defendant

Francis J. Murray (Edward R. Korman, United States Attorney of Counsel) for the Government

Dooling, D.J.

Defendant, by renewed motion for a judgment of acquittal, and by motion for a new trial, again argues the admissibility in evidence of the statement under oath (in question and answer form) that Segundo Martinez made to the Internal Revenue Service on April 25, 1975. It was offered during trial under Rule 804(b)(1) (former testimony) and (b)(5) (other exceptions) and was excluded.

Martinez, later joined as a defendant in two counts of the indictment was adequately shown to be unavailable. A naturalized citizen of the United States, he had left this country for his native Colombia before the indictment was

presented; he was unwilling to return for the trial, assigning as a reason that he had regular employment in Colombia which could be jeopardized by his absence. He could not, it appears, be extradited to answer the charge of the indictment. Counsel who appeared for Martinez advised that his client had advised him that if he was called to give a deposition in Colombia he would assert his Fifth Amendment privilege against self-incrimination. The Government had declined to offer Martinez immunity.

During the trial defendant contended that he had instructed Martinez, the comptroller of Ostrow Textile Company, Ltd. and Plej's, Inc., to charge to his loan account (presumably with Ostrow Textile) the large sums paid out by the two companies, principally in connection with the construction of his residence in Charlotte, North Carolina. In the event, none of the disputed amounts was charged to the loan account (which, however, really existed and reflected advances and repayments on defendant's account), and defendant explained that as error on the part of Martinez, undiscovered because defendant had no connection at all with the bookkeeping. The Government contended that the amounts so expended by the companies were taxable gross income to defendant, not loans, and that there was no truth in defendant's contention that the expenditures were intended and believed to have been treated as loans.

When Martinez was questioned by the Internal Revenue Service on April 25, 1975, he was represented by counsel who also represented defendant and his brother Joel Ostrow; Martinez was then still employed by Ostrow Textile as comptroller; he had been that for two or three years, he said, and before that had been, more or less, Office Manager. In his interrogation Martinez said that when he was at the Rock Hill, South Carolina, office of Ostrow

Textile he wrote out most of the firm's checks but could not sign them; that he made certain of the entries in the Ostrow Textile cash receipts book of 1971; that after October 2, 1972, the cash receipts book was posted in Rock Hill under his supervision, and contained entries in his handwriting; that he made no entries in the 1971 cash disbursements journal, which was maintained in New York in 1971 although it reflected checks drawn in Rock Hill as well as in New York; that the 1972 and 1973 cash disbursements journal did contain entries in his handwriting; this journal, or check register was kept under his supervision so far as it recorded disbursements by check; under the system (initiated in September 1972) a check entry in one writing filled out the check, by carbon impression transferred its data to a subsidiary ledger card, and by carbon impression transferred its data to the check register; that purchases of merchandise were handled through the accounts payable (distribution) column of the check register, as would be charges for supplies or to loans; that all direct distribution (*e.g.*, expenses) was posted manually; that neither defendant nor his brother Paul ever reviewed the check register (or cash disbursements journal); that the monthly reconciliations of receipts, disbursements and bank balances that he prepared for the firm's outside accountants reflected beginning accounts payable, net purchases of the month, including all items charged to accounts payable and all payments made on accounts payable; that after August 31, 1972, the Plej's check register was similarly maintained, he made entries in it, and prepared similar monthly summaries; that he wrote out the Ostrow Textile check for $15,000 dated September 10, 1973, that defendant signed, and that it was charged to accounts payable.

The critical part of the Martinez interrogation followed:

Appendix B

Q. (Edwards) Did you know the purpose of the check at the time it was written? A. I can say yes.

Q. (Edwards) And what was the purpose of that check? A. That time we started making checks at Rock Hill it was construction of Mr. Paul Ostrow's house. He told me some bills were coming to be paid. He told me to make a check for $15,000 and I charged it to accounts payable.

Q. (Edwards) You are then saying that Paul Ostrow did instruct you as to how this particular check should be charged? A. No, he didn't. He implied that it be charged to his account, but he told me there were more bills coming.

Q. (Edwards) Did Paul Ostrow give you any further instructions on the charging of this check? A. I don't remember.

Q. (Greene) How was the check finally charged, the end result of the check. Did it go into purchases, loans, or what? A. In this case, was charged to accounts payable.

Q. (Greene) Did Mr. Ostrow instruct you to make a list of payments on his behalf? A. Yes.

Q. (Greene) And did you make this list? A. Yes, I made the list and I lost the list.

Q. (Greene) What was the purpose of this list? A. To charge to his account.

Q. (Greene) How was it to be charged to his account? A. Like a loan.

Q. (Greene) After you lost the list, what did you do then? A. I forgot about it, and I was busy, so I forgot about it and didn't charge it to him.

Ritholz: As of the end of 12/31/73.

Appendix B

Q. (Edwards) At the time you filed the corporate tax return of Ostrow Textile for the year 1973, were you aware at that time that this check had been included in purchases on the corporate return? A. At that time, when they made the return, I forgot to tell those people to check that.

Q. (Edwards) You forgot to tell whom? A. The accounting firm. I keep everything in my memory was too hard. I feel it was to be charged to Paul Ostrow at the end of the construction of his house.

Q. (Edwards) Did you ever inform Paul Ostrow that you had lost the list? A. No, I didn't.

Q. (Edwards) Did Paul Ostrow ever ask you if this had been charged to him? Before approximately 3/15/74? A. I don't remember.

Q. (Edwards) Did he ask you after that date?

Ritholz: Well, I think that is outside the scope of the summons, so I will instruct the witness not to answer.

Q. (Greene) When you wrote all these checks for the building of his home, did Paul ever give you any invoices from which you write the check? A. Yes.

Q. (Greene) Sometimes he would give you invoices and sometimes nothing? A. I was supposed to keep track of it.

Then followed a series of questions about a few specific Ostrow Textile and Plej's checks, dated from March to September 1973, payable to subcontractors who worked on defendant's house upon invoices that they had rendered to Ruth Holland, the general contractor on defendant's house, and which were charged either to accounts payable or (in Plej's case) to repairs and maintenance. Martinez answered the questions in the same sense, saying as to Plej's:

Q. (Greene) Was the list you referred to which reflected payments for Mr. Ostrow's house included both the checks from Plej's and the checks from Ostrow Textile Company? A. Yes, they were reflected on the same list.

Q. (Greene) And this was the list that was lost? A. Yes.

Q. (Edwards) At the time of filing of the Plej's corporate tax return for the year ended 9/30/73, were you aware that this particular check had been charged to repairs and maintenance? A. I will give you the same answer I gave you about the other checks—I was supposed to advise these people about the bills that was paid on Mr. Ostrow's account.

Q. (Edwards) And whom were you supposed to advise? A. The accounting firm.

Q. (Edwards) And why did you not so advise the accounting firm that you had lost the list? A. Because at first I realize I lost the list, I realize it was important for the accountant. I was to keep a list to be charged to Mr. Ostrow.

Q. (Edwards) Prior to 4/15/74, did Mr. Paul Ostrow ever comment to you or inquire to you about repayment of these loans or what he assumed to have been loans? A. I don't remember about that. I can't tell you exactly.

Q. (Edwards) Prior to 4/15/74, did you inform Paul Ostrow that you had in fact lost the list? A. No, I didn't.

Q. (Edwards) Did you inform him after 4/15/74?

Ritholz: That is outside the scope of the summons.

Q. (Greene) Well, you could file an amended return. (Edwards) Prior to 4/15/74, did any of the Ostrows

ever suggest or imply to you or it would nice if the list were lost or misplaced? A. Oh, no, never.

Martinez was recalled by the Internal Revenue Service and again was accompanied by counsel. His Fifth Amendment rights were explained to him. He declined on advice of counsel to answer questions about the location of the alleged list of expenditures and refused to testify about the purchases register of Ostrow Textile that was exhibited to him, or about the identities of those who posted entries in it.

During the trial defendant produced (Exhibits A-1), a listing on a ledger form of the data from a good number (but not all) of the checks drawn to pay for work on defendant's house; the form of the entries is such as to make it plain that they were counterpart writings (carbon or original) of entries in the corporate accounts (Exhibits 70, 66) some of them in the handwriting of Martinez. Exhibit A-1 was not authenticated beyond its connection into the accounting records and the identification of the writers of the entries; all the items, however, were connected with the construction of defendant's house.

The transcript of the Martinez interrogation was excluded on the ground that it did not qualify under Rule 804(b)(1) nor under Rule 804(b)(5).

While *ex parte* examination of a witness may in some cases be a fair enough equivalent to direct and redirect questioning or to cross-examination, it must be doubted that *ex parte* examination by agents of the Internal Revenue Service is within the idea of a "hearing" in a "proceeding"; those words are used in the rule in the context of an adversary motivation of "direct, cross or redirect examination." The exploratory inquiries of the Service, not here

refined to the point at which the Service recognized a need to warn Martinez of his Fifth Amendment rights, are not openly adversary proceedings nor so analogous to them that they should put the Service on notice that it must exhaust each witness by use of cross-examining techniques, and be armed with records to meet every turn the answers may take. The Service might have been warned here by the presence of counsel that defenses were up, but they did not have to be and evidently were not so warned. If they mistook an adversary for a neutral accounting witness, they were not at fault.

It is basic to Rule 804(b)(1) that the opportunity as well as the motive to examine the witness be present. Two circumstances prevented the Service from having a full opportunity to elicit the whole of the witness's testimony. They were not permitted at the first session to make any inquiries about conversations between Martinez and defendant after the subpoena cut-off date concerning the alleged list, its loss, and the lapse of memory about charging the expenditures to defendant's loan account. At the first session the Service, whether or not it could have done so, did not have the purchase journal at hand to use in questioning Martinez, nor did it, aparently, then have the anomalous Exhibit A-1. When Martinez was recalled for further examination, his assertion of his Fifth Amendment right frustrated further inquiry. And, finally, the Service, unaware that Martinez was to become equally unavailable to it and to defendant, had no motive to pursue the questioning at the first session when Martinez advanced the loan theory until it was better prepared, with accounting records and analyses of them, to conduct a complete examination of the witness.

United States v. *Brown,* 10th Cir. 1969, 411 F.2d 1134, is the other way on vastly simpler facts, but it is not persuasive that such *ex parte* examinations of third party witnesses should be treated as prior testimony in an adversary proceeding.

Defendant complied before trial with the notice requirement of Rule 804(b)(5). However, the Martinez statements have not the "equivalent circumstantial guaranties of trustworthiness" that characterize the exceptions listed in Rule 804(b)(1) through (4). It is, of course, not more probative of the point in issue than the defendant's own testimony given under oath at the trial, nor than his father's evidence. It was, of course, if admissible, technically corroborative to the extent that it could be believed, although one may well guess that its ludicrous incredibility would have hurt rather than helped. It cannot in any case be concluded that the general purpose of the rules would be served by admitting the statement. All the circumstances of the statement conspire against its trustworthiness.

The motion, so far as based on the exclusion of Martinez's statement must be denied.

It is argued that the alleged additional income was neither compensation, nor embezzled funds, nor constructive dividends, and that, therefore, the Government failed as a matter of law, or, at least, as a matter of the weight of the evidence, to prove underpayment of tax or consciousness of such an underpayment. The instructions on the law given to the jury required them to find as a condition of conviction whether the amounts represented by the checks of Ostrow Textile and Plej's were income or non-taxable receipts; they were required first to decide whether the amounts were loans to defendant and, in that connection, to take into account the intentions of the parties to the transactions in

deciding whether the amounts were loans or a diversion of corporate funds to personal use. Specifically, the charge instructed the jury:

> "Hence defendant's intention in issuing the corporate checks is critically important, and you must determine on all the evidence, whether defendant did arrange, with his father's approval, to borrow the money from the companies with the intention of repaying it. The Government has the burden of establishing beyond a reasonable doubt that the amounts paid out for the homebuilding were not drawn from the companies for the defendant as loans or advances which he meant to repay in due course, or as any other non-taxable type of receipt; the defendant does not have the burden of proving that they were loans, or of otherwise disproving the Government's case.
>
> "Regarding only the checks and the uses to which they were put, the law is clear that if the amounts of the checks were loans to the defendant they were not income to the defendant. If they were intended as additional compensation to the defendant for his services to the two companies over and above the salary and expense allowance which he received from Ostrow Textile Company, these amounts would constitute taxable income to defendant and his wife which should have been included in their tax returns. If the amounts were not loans, nor additional compensation for services, and if they were not impressed with any other specific character by defendant and whoever else knew of the drawing of the checks on the companies, then they would as a matter of law constitute taxable income to the defendant. The Internal Revenue Code imposes a tax on "all income from whatever source derived" with certain specific

> exclusions, and, where amounts are received directly, or, as here, are expended for one's benefit, such amounts cannot be treated as falling within an exclusion unless the evidence affirmatively shows that the payment had the characteristics of one of the classes of income which is excluded from tax, such as gifts, inheritances, compensation for injuries (received, for example, under the Workmen's Compensation Law) and other such specifically excluded types of income. The Government, therefore, must show that the amounts were not within any exclusion. Bear in mind also that the final moment for the resolution of questions of intention is not necessarily the moment when the payment is made or the check is cleared or the first book entry is made. The final moment is when at year end the corporate records are reviewed and closed and the individual and corporate tax returns are prepared and filed. But when the tax return is signed and filed, what is then the fact, is decisive.
>
> "Bear this very much in mind; the ultimate test is what defendant understood in good faith at that time. If he, in good faith, thought that the amounts were not income to him, whether they were or were not loans, then, since we are dealing with a criminal statute, and not a civil liability, he would not be answerable criminally. We will return to this point when we come to consider the second essential element."
>
> * * *
>
> "If you conclude that for any year or years there was a substantial amount of tax due and owing over and above that shown on the return for that year or for those years, then you must go on to consider the second essential element, that is, that defendant knew when he filed the income tax return that he and his

> wife owed substantially more tax than was shown on the tax return as filed. The statute, a criminal statute, is not concerned with under-reporting and underpayment of tax that result either from innocent mistake, or careless inattention, or negligent reading of the instruction. Hence, you must be satisfied from the evidence that defendant knew substantially more tax was due then he was reporting in the tax return. The Government does not have to prove that by direct evidence, but it must prove facts and circumstances from which you are able to and do infer beyond a reasonable doubt that the defendant knew when he signed the return and has it filed that that it substantially understated the tax liability for the year."

The jury's verdict reflects its rejection of defendant's evidence that the corporations were authorized by his father (their sole stockholder) to lend defendant the homebuilding amounts; the verdict necessarily implies the conclusion that they were amounts drawn from the business by its principal executive officer for his personal and family uses without the intention of repayment. That they could not, strictly, be dividends, since defendant was not a stockholder, nor found to be intended to be compensation, since there was no evidence of that, does not signify that they were not taxable income to defendant. The state of the evidence excluded the inference of a non-taxable source or characterization of the funds; the Government did enough in showing the source and use of the funds, and in persuading the jury that they were not lent or advanced to defendant. The inference of unauthorized use of corporate funds, of diversion of corporate funds, was overwhelming, and connoted taxability (*James* v. *United States*, 1961, 366 U.S. 213), and if it were supposed that the sole stockholder simply tolerated the use of the funds without demanding their return or expecting their repayment, the case would be no better. Receipts are income unless they are identifiable as having a distinctive non-income quality—repayment of a loan or a gift, or a legacy, etc. Receipts do not have to have a particular qualifying character to become income; on the contrary, they must have a distinctive qualified character to avoid being income. Taxable gross income is the residual class of receipts from whatever (not statutorily exempt) source derived. The cases defendant relies on are stockholder cases: the stockholder had the right to get funds from the company simply as stockholder; whether the funds received were dividends or a return of capital determined their taxable status, and such was the analysis. *Cf. United States* v. *Leonard,* 2d Cir. 1975, 524 F.2d 1076, 1083-1084; *DiZenzo* v. *Commissioner,* 2d Cir. 1965, 348 F.2d 122, 126-127. But an employee, not a stockholder, who diverts funds even from an insolvent corporation does not escape the consequences of the *James* case. Here, the verdict implies a finding that defendant believed the funds were income, and that defendant sought to evade the tax on them by omitting them from his returns knowing that they were taxable income. There was no error in law involved and the evidence sufficed to support the jury's conclusion.

The final contention, that there was no proof of affirmative acts of fraud to support the verdict, is without substance. Without analyzing the evidence to show that affirmative acts were amply shown, it is enough to point out that defendant's argument essentially is that it is not enough to show that defendant intentionally filed a return that he knew understated his income and his liability for the purpose of avoiding the payment of the tax that he knew he owed. But it is. What *Spies* v. *United States,* 1943, 317

Appendix B

U.S. 492, 499, means is, simply, that evidence of intention may be found in corrupt bookkeeping, and like activities. It neither says nor implies that such activities are the sole means of proving the crime. The culpable affirmative act in the end is always the filing of the return known to understate income and tax and filed for the purpose of not paying the tax known to be due. The back-up of false invoices and altered books, prepared to make the fraudulent return look truthful, is not the offense, although when umasked it simplifies proof of the guilty intention.

It is, accordingly

ORDERED that the defendant's motion to set aside the verdict and for a judgment of acquittal, and the alternative motion for a new trial are denied.

Brooklyn, New York
March 2, 1979.

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U.S.D.J.

APPENDIX C

Rule 804—Hearsay Exceptions; Declarant Unavailble

(a) Definition of unavailability.—"Unavailability as a witness" includes situations in which the declarant—

(1) is exempted by ruling of the court on the ground of privilege from testifying concerning the subject matter of his statement; or

(2) persists in refusing to testify concerning the subject matter of his statement despite an order of the court to do so; or

(3) testifies to a lack of memory of the subject matter of his statement; or

(4) is unable to be present or to testify at the hearing because of death or then existing physical or mental illness or infirmity; or

(5) is absent from the hearing and the proponent of his statement has been unable to procure his attendance (or in the case of a hearsay exception under subdivision (b)(2), (3), or (4), his attendance or testimony) by process or other reasonable means.

A declarant is not unavailable as a witness if his exemption, refusal, claim of lack of memory, inability, or absence is due to the procurement or wrongdoing of the proponent of his statement for the purpose of preventing the witness from attending or testifying.

(b) Hearsay exceptions.—The following are not excluded by the hearsay rule if the declarant is unavailable as a witness:

(1) Former testimony.—Testimony given as a witness at another hearing of the same or a different proceeding, or

in a deposition taken in compliance with law in the course of the same or another proceeding, if the party against whom the testimony is now offered, or, in a civil action or proceeding, a predecessor in interest, had an opportunity and similar motive to develop the testimony by direct, cross, or redirect examination.

(2) Statement under belief of impending death.—In a prosecution for homicide or in a civil action or proceeding, a statement made by a declarant while believing that his death was imminent, concerning the cause or circumstances of what he believed to be his impending death.

(3) Statement against interest.—A statement which was at the time of its making so far contrary to the declarant's pecuniary or proprietary interest, or so far tended to subject him to civil or criminal liability, or to render invalid a claim by him against another, that a reasonable man in his position would not have made the statement unless he believed it to be true. A statement tending to expose the declarant to criminal liability and offered to exculpate the accused is not admissible unless corroborating circumstances clearly indicate the trustworthiness of the statement.

(4) Statement of personal or family history.—(A) A statement concerning the declarant's own birth, adoption, marriage, divorce, legitimacy, relationship by blood, adoption, or marriage, ancestry, or other similar fact of personal or family history, even though declarant had no means of acquiring personal knowledge of the matter stated; or (B) a statement concerning the foregoing matters, and death also, of another person, if the declarant was related to the other by blood, adoption, or marriage or was so intimately associated with the other's family as to be likely to have accurate information concerning the matter declared.

(5) Other exceptions.—A statement not specifically covered by any of the foregoing exceptions but having equivalent circumstantial guarantees of trustworthiness, if the court determines that (A) the statement is offered as evidence of a material fact; (B) the statement is more probative on the point for which it is offered than any other evidence which the proponent can procure through reasonable efforts; and (C) the general purposes of these rules and the interests of justice will best be served by admission of the statement into evidence. However, a statement may not be admitted under this exception unless the proponent of it makes known to the adverse party sufficiently in advance of the trial or hearing.

APPENDIX D

(1615)

Mr. Ritholz: He knew that they were charged to expenses in the case of Plej's—

Mr. Murray: To the contrary, there were any number of explanations that could have been—

The Court: We have to spend a good deal of time on this, because it's perfectly clear that if this is kept out and a conviction follows, and it is error to keep it out, that the conviction will have to be reversed. No question about that in my mind. It doesn't make any difference what accounts we're talking about, because something of the sort falls in the record.

On the other hand, if it is admitted, I am not at all sure what its genesis is.

You never stop being a lawyer, of course, just because you're a judge. Indeed, the bar praises that you obtain some of those qualities after you become a judge. I think that on balance and if correctly handled, this is damaging testimony against the defendant. That is just a long-retired litigator's sense of a document.

This is the kind of document that is an albatross. I would have thought that the govern-

(1837)

The Court: As I say, I regret the Government's objection, but I conclude that the objection when made must be sustained. I do not think that the general purpose of rules and the interests of justice will be served by the admission of the statement into evidence in this case.

As I said to you earlier, I do not underestimate the importance of this ruling. I have no illusions

about its ever being harmless error, if it is error. Why do I rule this way? I think that—I am very much influenced by all of the circumstances of the taking of—that it was testimony taken by non-lawyers, in the course of an ongoing investigation, and at a time when whether or not they should have gone farther with their investigation and analyzed the materials they had seen more carefully, they did not. So that they did not really know how to exploit the witness, what materials to present to him and how to follow them up.

Now, I think the lawyer in the same situation, whose business is examining witnesses, would have gone farther. I think they did not, partly because they were thinking of it as an ongoing investigation and did not press. By the time they were ready to press, they were confronted with what they regarded as a